2/12/88 RS638-2

JAPAN · ECONOMIC · INSTITUTE

JEI

REPORT

NO. 4A

January 29, 1988

TRADE AND THE 100TH CONGRESS

Summary

Although the Democratic 100th Congress began with grandiose predictions that sweeping trade legislation would be a top priority, the trade proposals that were packaged as HR 3 ended 1987 stalled in conference committee. Nearly every major trade item has been postponed until the second session, although a handful of specific measures have been approved. Especially significant to Japan are two laws that affect trade in construction services and impose sanctions on Toshiba Corp. and its affiliates. This report will discuss the issues that are still awaiting action in 1988 and analyze those trade-related items that became law last year.

Status: Pending

The best summary of congressional action on trade issues during the first session of the 100th Congress is simple: still pending. Every major trade initiative that legislators considered during 1987 remains unfinished -- most obviously, the omnibus trade bill, which House Speaker Jim Wright (D, Tex.) and Senate Majority Leader Robert Byrd (D, W.Va.) had vowed to complete during the session. The bill's prospects appeared bright at the beginning of the year. The House passed HR 3 by the end of April; the Senate completed action in July.

The real holdup came at the conference committee stage. When the committee held its first organizational meeting in August, many observers still argued that the bill could be completed by the end of the year. Indeed, the

House and Senate leadership made it clear that they wanted to see a compromise by the end of October. But a number of factors combined to make the target unreachable. For example, every committee involved -- nine in the Senate and 14 in the House -- wanted the opportunity to name conferees to the committee. Their demands were especially important in light of several jurisdictional battles that were raging over trade issues. Mr. Wright and Mr. Byrd decided that the rights of these committees outweighed the advantages of simplicity and allowed each committee to participate in the conference. The result was a 199-member committee which, as it was too unwieldy, had to be subdivided into a convoluted system of 17 issue-specific subconferences.

Questions have been raised concerning Mr. Wright's motives in making this decision. Given the animosity between the Speaker and conference committee co-chairman Dan Rostenkowski (D, Ill.), some analysts have questioned whether he arranged the conference in a way that would undercut Mr. Rostenkowski's influence, since individual subconferences rather than the whole committee have the final word on their areas of negotiation. Others believe that the complex arrangement was designed so that the negotiations would continue well into 1988, thereby highlighting the issue in the presidential and congressional campaigns. Mr. Wright denies any ulterior motives. Whatever his reasons, the chairmen of the subconferences had trouble getting the negotiations off the ground. Only a handful of subconferences had met by the end of the year.

There were other reasons for the delay as well. As always, Congress' main preoccupation after the August recess involved fiscal matters. The tedious process of agreeing on FY 1988 appropriations and meeting the Gramm-Rudman-Hollings deficit target was enough to keep Congress busy until just before Christmas. Finally, many analysts suspect that the October 19 stock market crash was the coup de grace. Although spokesmen for the trade committees argued that a trade bill should calm shaky markets and that the crash would not affect the completion schedule, many legislators were extremely reluctant to pass legislation that is widely opposed on Wall Street and in global financial markets.

Conference committee chairmen -- Lloyd Bentsen (D, Tex.), head of the Senate Finance Committee and Ways and Means Committee chairman Rostenkowski -- hope to put a completed HR 3 on the president's desk by early spring, but others estimate that it may not be completed until the summer. There is even a possibility that the bill will not even get off the ground at all this year. (For a detailed discussion of the provisions of the House and Senate versions of HR 3, see JEI Report No. 36A, September 25, 1987.)

U.S.-Canada Free-Trade Pact

On January 2 President Reagan and Canadian Prime Minister Brian Mulroney signed a free-trade agreement that would (among other things) eliminate tariffs over the next 10 years on items shipped between the United States and Canada. The agreement, which is awaiting consideration by Congress and the Canadian Parliament, also includes a binding dispute resolution mechanism that overrides

The JEI REPORT (ISSN 0744-6489) is published weekly except for the New Year, Memorial Day, Labor Day, Thanksgiving and Christmas holiday weeks for $40 per year by the Japan Economic Institute of America, 1000 Connecticut Avenue, N.W., Washington, D.C. 20036. Second class postage paid at Washington, D.C. POSTMASTERS: Send address changes to JEI REPORT, 1000 Connecticut Avenue, N.W., Washington, D.C. 20036.

national trade laws. Under U.S. law Congress has to consider the agreement on a "fast track" basis, that is, within a limited amount of time and without the right to amend the pact. Canada faces no similar requirement.

Approval of the free-trade agreement is by no means guaranteed since neither country's legislative body has indicated its wholehearted support. Given the increasing interest in protectionist legislation in the United States, it is somewhat ironic that the agreement appears to have a better chance of approval in Washington than in Ottawa. Legislators generally support the pact, epecially since Canada is this country's most important trading partner.

On the specifics, however, they are cautious. Most have said that they want to study the agreement carefully before making a decision. And indeed, a few sore points have emerged. The automotive industry has expressed dissatisfaction with those elements of the agreement that affect trade in cars and trucks. Moreover, the constitutionality of the binding dispute resolution mechanism has been called into question by some Washington lawyers and may be subjected to greater scrutiny before Congress votes on the agreement. Finally, some legislators have complained that the White House should have allowed more congressional input on the FTA.

If there are reservations on the U.S. side, the objections are even greater in Canada. Parliamentarians have warned Congress that the FTA could run into serious trouble in Ottawa if Canada is not formally exempted from the provisions of HR 3. (They point out that Israel, which presently enjoys a free-trade agreement with the United States, is exempted under the language of the bill.) In addition to complaints of U.S. protectionism, there is a strong feeling in some business and government circles that the agreement is a threat to Canada's cultural sovereignty.

The White House has asked Congress to act promptly on the agreement, preferably before considering the omnibus trade bill. The request has fallen on deaf ears so far. Congressional leaders have announced their intention to finish work on HR 3 first. If the time limit under the fast track provision becomes a problem, legislators are apparently willing to consider attaching the free-trade agreement to the trade bill.

The fate of the pact is of significance not only to the United States and Canada but also to this country's relationship with Japan. Already there have been suggestions that a U.S.-Japan free-trade agreement would be a logical step if the pact with Canada is successful. In fact, during Prime Minister Noboru Takeshita's visit to Washington in mid-January, the Japanese leader agreed with Sen. Byrd to study the feasibility of a bilateral free-trade agreement patterned on the U.S.-Canada pact, although most observers believe this is premature. Not only are there certain barriers that neither country is willing to abandon, but the emotional overtones of U.S.-Japan trade frictions have created a congressional mood that is not conducive to such an agreement. Nor has the White House welcomed the suggestion with open arms.

Quotas On Textiles, Apparel and Footwear

The bill to impose stricter limits on imports of textiles, apparel and footwear may be pending in a technical sense, but most observers consider it

dead in the water for the remainder of the 100th Congress. HR 1560/S 549 is a revised version of the bill that passed the 99th Congress and was vetoed by the president. The proposal would establish global quotas based on 1986 import levels, a change from the 1985 bill, which targeted Asian countries and involved a rollback of imports (see JEI Report No. 8B, February 27, 1987.) Opponents of the proposal rejected not only the specifics of the bill but also questioned the need for tighter limits. They pointed out that the textile industry in particular is thriving (see JEI Report No. 19B, May 15, 1987). Since the House narrowly missed overriding the veto of the original bill in August 1986, the success of the new proposal depended not only on whether it passed but also whether it had enough congressional support to override another veto.

Consequently, when HR 1560 passed the House by a 263-156 vote September 16, analysts were quick to conclude that the results represented a defeat for the textile, apparel and footwear caucuses. The tally was 27 votes short of the two-thirds majority that is required to override. As a result, the Senate took no action on the bill. S 549 is on the Senate calendar for the second session and is expected to pass, but few observers believe that the proposal will survive the certain presidential veto.

One commentator recently noted that there always seems to be a textile bill before Congress. True. But since its supporters have said that they are by no means done fighting for tighter quotas, it is not likely that the issue will disappear anytime soon.

The Harmonized Code

On January 1, 1988 all the major trading nations but one implemented the Harmonized Commodity Description and Coding System, which is designed to simplify and integrate tariff schedules around the world. The United States was the sole exception. Although this country had signed the agreement, Congress failed to pass implementing legislation. The reason was simple. The legislation was included in the House and Senate trade bills. The House bill implements the new tariff classification system; the Senate version merely sets up a procedure for Congress to consider the code on a fast track basis.

When it became apparent that Congress would not finish work on the trade bill by the end of the year, some legislators suggested that the provisions on the new code be considered separately since U.S. participation in the new system is not a controversial issue. The idea was quickly squelched by legislative leaders, most notably Sen. Bentsen, who argued that doing so would begin the process of breaking up the bill. There was also an underlying current of fear that if the noncontroversial provisions were considered separately, not only would the provisions that remained in the bill lose congressional support, but the administration would no longer be under any pressure to sign HR 3.

Although the decision to keep HR 3 intact may have made good political sense for congressional leaders, it nonetheless constituted a minor embarrassment for American trade interests. The United States is now the only major trading country using a different system -- a system that is considered difficult to interpret and frustrating to use.

What Congress Passed

If legislators were unable to complete action on any of the major trade issues, they did not hesitate to attach a handful of trade provisions to other bills. A few of these will cause significant aggravation to Japanese industries; others are no more than minor headaches.

Construction Services - The administration's failure to win bidding rights for U.S. companies on the Kansai International Airport project has been an especially sore point in Congress. The issue was the most hotly discussed sectoral trade dispute on the Hill during the latter part of the year, and the adoption of a provision pressuring Japan to open its market to foreign architectural, engineering and construction companies was no surprise. Legislators attached a reciprocity amendment to the omnibus spending package (H J 395) that prohibits foreign firms from participating in federally financed public works projects if their government does not grant the same access to U.S. firms. The amendment does give the president a broad loophole to waive the prohibition if he decides that foreign participation would be in the public interest. (For a more detailed discussion of U.S.-Japan competition in construction services, see JEI Report No. 5A, February 6, 1987.)

Partly in response to this amendment a proposal was unveiled during Prime Minister Takeshita's January visit that would allow U.S. companies to bid on certain public works projects. The reaction in Washington was less than enthusiastic, both within the administration and on Capitol Hill. Secretary of State George Shultz and Foreign Minister Sosuke Uno did agree to working-level negotiations on the issue, but even that drew criticism from Sen. Frank Murkowski (R, Alaska), who charged that discussions have so far "got us nowhere." Sen. Murkowski has repeatedly urged the White House to initiate an unfair trade practices investigation under Section 301 of the Trade Act of 1974.

Toshiba Corp. - Most people expected Congress to be outraged that Toshiba Machine Co., Ltd. had illegally sold sophisticated milling machinery to the Soviet Union that gave the USSR the capability to build quieter submarines. But few Americans or Japanese were prepared to see a small group of congressmen take sledgehammers to Toshiba products on the Capitol grounds. Not only did that display receive international attention but it also gave observers an idea of the extent of the legislators' rage.

Nonetheless, the legislative fallout has been less than expected. A number of bills that lash out at both Toshiba Machine and its parent, Japan's second-largest electric machinery maker, have been introduced since the disclosures last summer. One of the most stringent, which would ban imports from both firms for two to five years, has been included in the Senate version of the omnibus trade bill. None had been enacted into law, however, until the passage of the deficit reduction bill (HR 3545). That bill includes a provision that prohibits the Defense Department from buying products from parent Toshiba or its subsidiaries, and forbids the sale of Toshiba goods at U.S. post exchanges throughout the world.

The Ministry of International Trade and Industry criticized the provision harshly and announced that it would file a formal protest with the White House. MITI said that the decision is a violation of Japan's independence since it ignores the fact that Tokyo has already enacted laws to punish the offenders and to tighten the enforcement of Japan's export control mechanisms.

While there is no doubt that the ban is a blow to the Toshiba Group, its enactment may forestall the adoption of more severe measures. As the end of the first session approached, the momentum on Capitol Hill to avenge the illegal sales was waning -- partially because a number of important U.S. corporations warned Congress that they depended on Toshiba parts for their products. Few observers think that Congress will forget the incident entirely, but now that some action has been taken Japanese businessmen are hoping that other pending proposals, including the provision in the trade bill, may be toned down or dropped. Nonetheless, some legislators, including Sen. Jake Garn (R, Utah), are still determined to include more punitive measures in HR 3.

Another repercussion of the Toshiba scandal involves the proposed changes in the U.S. export control law. The House version of HR 3, which aims for a 40 percent reduction in the number of items on the export control list and limits Department of Defense review of license requests, may simply be indefensible at this point. Given the publicity surrounding the administration's demands for tighter international control of exports to communist countries, it will be difficult to defend a large-scale liberalization scheme. And although House Foreign Affairs international economic policy and trade subcommittee chairman Don Bonker (D, Wash.) insists that his committee's liberalization plan is completely separate from problems surrounding illegal diversions, most conferees see a clear link. In short, although all agree that simplification of the export control list is desirable, the Toshiba scandal may lead conferees to adopt a very conservative approach.

U.S.-Japan Nuclear Pact - After some five years of negotiations, the United States and Japan initialed an agreement in November granting Japan a 30-year permit to ship nuclear fuel purchased from the United States to other countries for reprocessing and to transport the reprocessed product by air back to Japan. At present, permission is needed on a case-by-case basis. Approval has never been granted for an airlift, although the United States did allow the shipping of plutonium in 1984 -- with a U.S. naval escort.

No sooner had legislators begun consideration of the treaty, however, than it ran into trouble. The Senate Foreign Relations Committee decided in a bipartisan vote to send the treaty back for renegotiation because of environmental, health and political concerns. Critics pointed out that Japan has yet to develop a fuel container that would withstand the impact of a plane crash. This concern was especially worrisome to legislators who represent Alaska and other northwestern states since Japanese airlifts would fly over those areas. Furthermore, there were concerns that non-proliferation goals could be jeopardized since Tokyo has not provided a detailed plan of safeguards against diversions of nuclear materials from Japanese plants to other countries. Over 20 members of the House Foreign Affairs Committee signed a letter to the administration echoing these objections. In a similar move, legislators attached a provision to the budget reconciliation package to prohibit airlifts of plutonium over U.S. territory unless the Nuclear Regulatory Commission has certified to Congress that the plutonium container will not break if dropped from an airplane's maximum cruising altitude.

Strategic Defense Initiative - Legislators tacked a "buy America" amendment concerning Strategic Defense Initiative projects to the Defense Authorization bill (HR 1748). The provision prohibits the Defense Department from granting contracts for research, development, testing, or evaluation of SDI-related projects to a foreign government or firm as long as a domestic company is competent to carry out the terms of the contract. An exception would be

made if the foreign firm or its government pledges to underwrite "a substantial portion of the total contract cost." The bill's report language stresses that legislators will keep a close eye on the terms of this exception to insure that the "substantial" contribution does not end up amounting to only a fraction of total contract costs.

The SDI amendment, which was the brainchild of Rep. Les AuCoin (D, Ore.), is partially a result of congressional anger at what legislators believe is an administration attempt to buy international support for SDI through promises of profitable contracts. Mr. AuCoin said that the purpose of the proposal is to maximize the chances that "any jobs produced by SDI technology and by SDI research should go to Americans first." Supporter Pat Williams (D, Mont.) concurred and argued that the initiative is also designed "to stop the United States from becoming involved in internationl pork-barreling" (see JEI Report No. 21B, June 5, 1987).

Compact Trucks - This "buy America" provision takes aim at DOD's 1986 contract with Mitsubishi Heavy Industries, Ltd. for over 3,000 compact pickup trucks. The Defense Authorization bill contains a provision sponsored by Michigan Democrat Dennis Hertel that prohibits DOD from purchasing "administrative motor vehicles" manufactured outside the United States or Canada during fiscal years 1988 and 1989 unless the contract is for less than $50,000 or is specifically authorized by law. Certain further exceptions apply to vehicles for use outside the United States. Mr. Hertel defended his proposal by saying that the United States is already subsidizing Japan's defense and the Pentagon should not be allowed to buy Japanese vehicles when so many American auto workers are unemployed.

Japanese Foreign Aid - Another amendment to the same bill concerns Tokyo's use of economic assistance as its primary contribution to international stability. Since most legislators are well aware of the political difficulties associated with U.S. demands for increased Japanese defense spending, the proposal praises Tokyo for the strides it has made in raising defense expenditures and implicitly acknowledges the validity of using foreign aid as a substitute for defense contributions. But the amendment outlines a five-point agenda that constitutes a "politically acceptable and significant global security role consistent with [Japan's] economic status."

First, the proposal suggests an increase in development assistance programs and defense spending so that the ratio of outlays to Japan's gross national product is roughly equal to those of other members of the North Atlantic Treaty Organization. Sen. John McCain (R, Ariz.) has estimated that in 1985 Japan's spending in these categories was only ahead of Luxembourg's; all other NATO members spent more than Tokyo's 1.29 percent of GNP (see Table).

The other four elements of this "sense of the Congress" amendment cover areas that Japan is already taking steps to accomplish. They are: (1) increasing aid to countries that are vital to global stability -- with a greater priority on non-Asian countries -- including such strategic areas as the Philippines and countries in Oceania, Latin America, the Caribbean and the Mediterranean; (2) increasing funds for untied grants and other concessional aid, as well as raising contributions to multilateral financial institutions; (3) pinpointing those countries that will receive increased aid through consultations with Japan's security partners; and (4) "further enhancing" Tokyo's pledge to contribute to global security after completing its FY 1986-FY 1990 defense program.

Defense and Foreign Aid as a Percentage of GNP*

NATO Nations and Japan	Defense	Foreign Aid	Total
United States	6.9%	0.24%	7.14%
Greece	7.1	--	7.1
United Kingdom	5.2	0.34	5.54
France	4.1	0.78	4.88
Turkey	4.5	--	4.5
Norway	3.3	1.03	4.33
Netherlands	3.1	0.91	4.01
West Germany**	3.2	0.47	3.67
Belgium	3.0	0.54	3.54
Portugal	3.1	--	3.1
Italy	2.7	0.31	3.01
Denmark	2.2	0.80	3.0
Spain	2.9	--	2.9
Canada	2.2	0.49	2.69
Japan***	1.0	0.29	1.29
Luxembourg	1.1	--	1.1

*Figures do not include security assistance.
**Does not include U.S. forces in West Berlin.
***Japan's defense figures exclude certain items, especially military pensions, that are included in NATO country figures.

Source: Office of Sen. John McCain. Derived from Department of Defense, Report on Allied Contributions to the Common Defense and Organization for Economic Cooperation and Development, Development Cooperation.

This amendment is far less objectionable to Japan than the original Senate proposal. Rather than suggesting that Japan increase foreign aid and defense spending to a level roughly equal with other NATO members, the original proposal called on Tokyo to boost aid expenditures to 3 percent of GNP by 1992, regardless of any increases in defense expenditures. (Japan's ODA/GNP ratio was 0.29 percent in 1986.) Finance Minister Kiichi Miyazawa expressed his anger at the proposal since it came in the midst of implementing a $30 billion Japanese initiative for developing countries (see JEI Report No. 41A, October 30, 1987).

Japan's Trade With Vietnam - Yet another addition to the Defense Authorization bill calls on Japan to reduce its economic ties with Vietnam. Sen. Robert Kasten's (R, Wis.) resolution establishes a congressional finding that Japan's trade with Vietnam has expanded steadily since 1982. The amendment encourages Japan to continue denying economic assistance to Vietnam; refrain from giving Vietnám any type of trade financing or private financing; and continue to discourage Japanese exports of goods and technology to Vietnam. It urges Japan to especially discourage sales of equipment that enhance (1) oil exploration and development projects, (2) forestry and fishery production, (3) production of commodities for light industries and (4) export capacity.

Ministry of Foreign Affairs spokesmen have pointed out that in yen terms, Japan's trade with Vietnam actually decreased in 1986. Two-way trade did

expand during the 1983-85 period, but the 1986 figure fell 9.6 percent from a year earlier. But since the Senate cited trade figures in dollar terms, its results are different, showing 1986 trade with Vietnam up 27.2 percent as the yen appreciated 26 percent over the course of the year.

A Look Ahead

When Congress reconvened January 25 legislators faced a full trade agenda. Issues such as the omnibus trade bill, the U.S.-Canada free-trade agreement and the harmonized code top the list. Sectoral issues are also likely to remain at the forefront, including the textile-apparel-footwear bill and a number of specific U.S.-Japan trade issues. Market access problems in construction services and agriculture will continue to be a major concern on Capitol Hill. Of particular importance to Western legislators will be Japan's decision on liberalizing beef and citrus quotas on April 1. And an announcement as to whether Japan will continue to limit its car exports to this country and at what level is anxiously awaited on Capitol Hill.

The fate of HR 3 is contingent upon a variety of factors: other agenda items, the country's economic health, legislators' perceptions of constituent attitudes and administration-Capitol Hill relations, and internal political battles in Congress. And although predictions about the bill are rampant in Washington, these fall into three major categories. First, the administration-Congress cooperation may solidify into a constructive working pattern, which would produce a moderate bill that eliminates the most objectionable provisions of the House and Senate versions -- a scenario quite similar to the trade legislation that emerged in 1984.

Second, the political motives and protectionist rhetoric that have influenced the trade debate could gain the upper hand, resulting in a bill that combines the harshest elements of both proposals. The White House has pledged to veto this type of trade bill, and the likelihood of a veto override appears dim. Finally, the conference committee may agree on moderate legislation that nonetheless has a few elements that are unpalatable to the admnistration, for example, plant closing notification. If the president vetoes the bill on the basis of one objectionable provision (as he has threatened to do), congressional trade leaders would stand a good chance of leading a successful override.

It is almost inevitable that economic issues will be even more highly politicized than usual during an election year. But the health of the national economy may be no less important than politics in determining whether HR 3 will become a moderate or harsh law, or even whether it will die this year. If the economy remains uncertain -- hovering on the edge of a recession -- legislators on both sides of the aisle could easily decide that a radical trade bill may not be the wisest course to follow at present. Too, the wobbly nature of the markets since the October 19 crash is certain to make lawmakers keep a wary eye on economic indicators -- not least of which are the trade statistics.

For further information, contact Eileen M. Doherty.

* * * * * *

The views expressed in this report are those of the author and do not necessarily reflect those of the Japan Economic Institute.